

## **REPORT OF THE AUDITOR-GENERAL TO THE MPUMALANGA PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE NKOMAZI LOCAL MUNICIPALITY**

### **REPORT ON THE FINANCIAL STATEMENTS**

#### **Introduction**

1. I have audited the financial statements of the Nkomazi Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

#### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified opinion**

### **Expenditure**

6. The municipality did not have adequate systems to ensure that invoices were recorded in the correct accounting period. Transactions relating to the previous accounting period were recorded in the current period and some of the transactions were recorded inclusive of value-added tax. Consequently, repairs and maintenance, bulk expenditure, contracted services and general expenses amounting to R22 069 963, R54 728 082, R23 582 084 and R122 417 714, respectively, as disclosed in the notes to the financial statements, are misstated.

### **Qualified opinion**

7. In my opinion, except for the effects of the matter described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Nkomazi Local Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

### **Emphasis of matters**

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

9. As disclosed in note 48 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of an error discovered during the year ended 30 June 2013 in the financial statements of the municipality at, and for the year ended, 30 June 2012.

### **Material losses**

10. As disclosed in note 58 to the financial statements, material losses of R64 297 698 and R26 701 471 were incurred as a result of water distribution losses and electricity distribution losses, respectively.

### **Material impairments**

11. As disclosed in notes 8 and 10 to the financial statements, material impairments relating to receivables from non-exchange transactions and consumer debtors from exchange transactions of R12 043 465 and R4 713 390, respectively, were incurred as a result of the provision for doubtful debt.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

12. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

### **Predetermined objectives**

13. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.

14. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability.
15. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
16. The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
17. The material findings are as follows:

#### **Usefulness of information**

##### **Presentation**

18. Section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for all measures taken to improve performance as disclosed in the annual performance report. This was because the documents provided were not appropriate audit evidence, as they did not support what had been disclosed in the annual performance report. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.

##### **Measurability**

19. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 24% of the indicators were not verifiable in that valid processes and systems that produced the information on actual performance did not exist. This was due to a lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information.
20. The FMPPI requires that indicators or measures should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. A total of 100% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was because management was not aware of the requirements of the FMPPI.

##### **Reliability of information**

21. The FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the information presented with respect to basic service delivery. This was due to limitations placed on the scope of my work because the municipality could not provide sufficient appropriate evidence in support of the information presented with respect to the development priority.

22. The FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets with respect to good governance and public participation were materially misstated. This was due to a lack of standard operating procedures for the accurate recording of actual achievements, monitoring of the completeness of source documentation in support of actual achievements, and frequent review of the validity of reported achievements against source documentation.

#### **Compliance with laws and regulations**

23. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

#### **Strategic planning and performance management**

24. The performance management system of the municipality did not provide steps to improve performance with regard to those development priorities and objectives where performance targets were not met, as required by section 41(1)(d) of the MSA.

25. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(i).

26. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(iii).

27. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls, as required by section 62(1)(c)(i) of the MFMA.

#### **Budget**

28. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

#### **Annual financial statements, performance report and annual report**

29. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets, liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

30. The council's oversight report on the 2011-12 annual report was not made public within seven days of its adoption, as required by section 129(3) of the MFMA.

## **Procurement and contract management**

31. Quotations were accepted from prospective providers who were not registered on the list of accredited prospective providers and did not meet the listing requirements prescribed by the supply chain management (SCM) policy, in contravention of SCM Regulations 16(b) and 17(b).
32. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding had been advertised for the required minimum period, as required by SCM Regulation 22(1) and 22(2).
33. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
34. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) (PPPFA) and SCM Regulation 28(1)(a).
35. Contracts and quotations were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
36. Sufficient appropriate audit evidence could not be obtained that contracts had been extended or modified only after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
37. Contracts were extended or modified without the approval of a properly delegated official, as required by SCM Regulation 5.
38. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
39. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
40. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB Regulation 18.
41. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who had submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM Regulation 13(c).
42. Awards were made to providers who are in the service of other state institutions or whose directors or principal shareholders are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM Regulation 44. Similar awards had been identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process, in accordance with SCM Regulation 38(1).

### **Human resource management and compensation**

43. An acting head of the SCM unit was appointed for more than six months, in contravention of section 56(1)(c) of the MSA.
44. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.

### **Expenditure management**

45. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.

### **Conditional grants**

46. Sufficient appropriate evidence could not be obtained that the municipality had timeously submitted project registration forms for projects it intended implementing in the 2013-14 financial year to the local government department, as required by the division of revenue grant framework issued in Gazette No. 35399.
47. Sufficient appropriate evidence could not be obtained that the municipality had submitted project implementation plans to the national department (CoGTA), as required by the division of revenue grant framework issued in Gazette No. 35399.
48. Sufficient appropriate evidence could not be obtained that the municipality had registered its master plans for bulk infrastructure with the integrated national electrification programme, as required by the division of revenue grant framework issued in Gazette No. 35399.
49. Sufficient appropriate evidence could not be obtained that projects funded by the integrated national electrification programme grant had been implemented in line with the details contained in the integrated development plan, as required by the division of revenue grant framework issued in Gazette No. 35399.
50. Sufficient appropriate evidence could not be obtained that the municipality had submitted MFMA implementation plans to the National Treasury to address weaknesses in financial management, as required by the division of revenue grant framework issued in Gazette No. 35399.

### **Internal control**

51. I considered internal control relevant to my audit of the financial statements, performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

52. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.

### **Financial and performance management**

53. Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting.
54. Management did not ensure that controls were implemented over daily and monthly processing and reconciling of transactions.
55. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
56. Management did not review and monitor compliance with applicable laws and regulations.

### **Governance**

57. The audit committee did not promote accountability and service delivery through evaluating and monitoring responses to risks and providing oversight of the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

### **OTHER REPORTS**

#### **Investigations in progress**

58. An investigation is being conducted by the special unit of the Hawks regarding possible irregularities in the sale and acquisition of land. The investigation was still ongoing at the reporting date.

*Auditor-General*

Nelspruit

30 November 2013



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